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MEMORANDUM FOR: Chief, OCI/WIS-E

SUBJECT : Economic Outlook for Argentina

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Attached is our contribution to NIO Memorandum,

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If you have further questions

please contact

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Chief,
Latin America Branch, OERAttachment:
As stated

Distribution: (E-5775)

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1. Peronist economic policies are directed at the short run objective of economic stabilization and the long run goals of economic development and redistribution of income in favor of wage earners. The relevant programs are being carried out under an economic philosophy which emphasizes state intervention and economic nationalism. Moreover, they tend to conflict. The social programs require outlays which are inflationary and divert resources from development projects, while the subsequent economic and political atmosphere discourages those with the funds and skills that Argentina lacks.

2. The Peronists did succeed in achieving some economic stability in 1973. When they assumed power in May, the country was in the midst of its worst inflation in 30 years. The cost of living had risen by 56% in 1972 and was running at an annual rate of about 75% during the first five months of the year. The Campora government quickly clamped a freeze on prices and rolled back some and limited the amount of wage increases. During the next five months, prices rose less than 1% and probably will end at 35% by the close of the year.

3. As a result of the halt of inflation, real gross domestic product (GDP) is expected to register a 4%-5% increase. The trade surplus is around \$900 million and the balance of

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payments surplus some \$650 million. Central bank reserves are thus more than doubled to nearly \$1.2 billion.

4. The outlook beyond 1973, however, promises more problems than progress. Although wage and price controls have halted the price spiral, inflationary pressures are mounting. Public spending continues to outstrip revenues at an alarming rate and the budget deficit in 1974 is expected to exceed the 8% of GDP registered in 1973. The volume of money in circulation has nearly doubled in the last 12 months. Large scale social welfare programs, such as the two-year, \$1.3 billion public housing program announced in July, will increase the deficit and divert needed funds to relatively unproductive endeavors. While recent Peronist tax reforms are expected to reduce tax evasion, government revenues are not likely to increase since the major thrust of legislative efforts is the redistribution of income through shifts in the tax burden.

5. The State's takeover of foreign trade in grain and meat is likely to worsen Argentina's economic difficulties. This action, combined with domestic price controls, has discouraged production of these items, the source of some 80% of Argentina's foreign exchange earnings. Thus, wheat plantings for the 1973/74 crop are down nearly 25% and wheat exports

are expected to fall from 3.2 million tons from the 1972/73 crop to around 1 million tons. The government also has had difficulty in assuring domestic supplies of beef -- despite record herds -- because controlled prices have deterred suppliers from slaughtering their cattle.

6. Meanwhile, Argentina continues to promote the development of manufactures for export and import-substitution. Most industries are heavily dependent on imports of raw materials and intermediate goods, further straining foreign exchange reserves. Argentina does not have the massive reserves it held in 1945, and an even more rapid deterioration of the Argentine economy is likely than occurred during Peron's previous tenure. The problems of balance of payments are also increased by Argentina's public external debt of about \$3.2 billion which requires service payments in excess of \$2.2 billion in 1973-75.

7. The clouded economic outlook, political uncertainty, and domestic terrorism have adversely affected the investment climate. At stake is some \$3 billion in foreign direct investment, of which \$1.4 billion is US. Buenos Aires recently passed foreign investment legislation restricting to 12.5% the amount of profit which can be remitted abroad. It also outlined discriminatory treatment of "Foreign" (51% foreign equity) and "mixed" (20%-50% foreign equity) companies

vis a vis "national" companies of less than 20% foreign equity. Although the law was apparently watered down at Peron's behest, it still inhibits the inflow of new investment from abroad.

8. Other negative considerations are indications of renewed moves against ITT subsidiaries in Argentina and the "renationalization" of foreign bank holdings acquired after 1966. The major threat to US investment, however, is Peron's aggressive promotion of trade with Cuba. As a result of some \$1.2 billion in credits granted to Castro's government, US subsidiaries have been pressed to export manufactured goods to Cuba in violation of US laws. The refusal of US firms to engage in such trade would lead to reprisals against them and charges of US interference in Argentina's affairs.